No. 10292

United States
Circuit Court of Appeals

For the Ninth Circuit.

BABOQUIVARI CATTLE COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of the Record

Upon Petition to Review a Decision of the Tax Court of the United States

ROTARY COLORPRINT, 590 FOLSOM ST., SAN FRANCISCO

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

APPEARANCES:

For Taxpayer:
JOHN W. TOWNSEND,
LLOYD FLETCHER, Esq.,

For Commissioner:
R. C. WHITLEY
E. L. CORBIN

Docket No. 103848

BABOQUIVARI CATTLE COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1940

July 18—Petition received and filed. Taxpayer notified. Fee paid.

July 18—Request for Circuit hearing in Washington, D. C., filed by taxpayer. 7/19/40 copy served.

July 19—Copy of petition served on General Counsel.

July 27—Amendment to petition filed by taxpayer. 7/29/40 copy served on General Counsel.

Sept. 17—Answer filed by General Counsel.

1940

Sept. 17—Request for hearing in Los Angeles, Calif., filed by General Counsel.

Sept. 30—Hearing set Oct. 23, 1940, on motion. Answer served.

Oct. 23—Hearing had before Mr. Mellott on request of petitioner for Washington, D. C., calendar. On request of respondent for Los Angeles, Calif. Granted to Washington, D. C., calendar.

Oct. 23—Order that proceeding be placed on the Washington, D. C., calendar for hearing on the merits entered.

Aug. 16—Hearing set Nov. 5, 1941.

Nov. 5—Hearing had before Mr. Mellott on the merits. Submitted. Appearance of Lloyd Fletcher, Jr., filed. Stipulation of facts filed. Petitioner's brief due 12/5/41. Respondent's brief due 12/20/41. Petitioner's reply brief due 1/5/42.

Nov. 13—Transcript of hearing 11/5/41 filed.

Dec. 5—Brief filed by taxpayer. 12/5/41 copy served.

Dec. 19—Motion for extension to Feb. 18, 1942, to file brief filed by General Counsel. 12/22/41 granted to Feb. 2, 1942.

1942

Feb. 18—Motion for leave to file the attached brief, brief lodged filed by General Counsel. 2/19/42 granted. 2/19/42 served.

1942

Mar. 18—Motion for leave to file the attached reply brief. Reply brief lodged, filed by taxpayer. 3/19/42 granted. 3/19/42 served on General Counsel. [1*]

Jun. 16—Opinion rendered. Mellott, Div. 11. Decision will be entered for the respondent. 6/16/42 copy served.

Jun. 16—Decision entered. Arthur Mellott, Div. 11.

July 15—Motion for rehearing and reconsideration of the opinion promulgated 6/16/42 and to vacate the decision entered June 16, 1942. (Brief in support thereof attached.) Filed by taxpayer.

July 20—Motion for rehearing and to vacate decision. Denied.

Sept. 14—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, filed by taxpayer.

Sept. 14—Proof of service filed by taxpayer.

Oct. 16—Agreed praecipe for record filed. [2]

*Page numbering appearing at top of page of original certified Transcript of Record.

United States Board of Tax Appeals

Docket No. 103848

BABOQUIVARI CATTLE COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice (IT:LA:PB-90D) dated April 20, 1940, and as a basis of its proceeding alleges as follows:

1. The petitioner is an Arizona corporation with principal office at Santa Margarita Ranch, Tucson, Arizona. The returns for the periods here involved were filed with the Collector of Internal Revenue at Phoenix, Arizona.

2. The notice of deficiency (a copy of which is attached hereto and marked Exhibit "A") was mailed to the petitioner on April 20, 1940.

3. The taxes in controversy are income taxes for the calendar years 1937 and 1938 and in the aggregate amount of $1,220.06.

4. The determination of tax set forth in the said notice of deficiency is based upon the following error:

(a) The Commissioner erred in including in petitioner's gross income payments received by it from the United States under the Soil Conservation and Domestic Allotment Act, in the amounts of $3,586.89 and $3,247.74 for the years 1937 and 1938, respectively.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows: [3]

(a) Petitioner is a corporation, organized and existing under the laws of the State of Arizona, and engaged in the business of raising cattle and other livestock for purposes of sale. In furtherance of such purpose, petitioner owns and operates a ranch located in the Southwestern part of Pima County, Arizona, consisting of approximately 7,319 acres of patented land (land owned outright by petitioner), 45,880 acres of land leased from the State of Arizona, and 4,000 acres of lands owned by the United States and allocated to petitioner under the Taylor Grazing Act, in all a total of approximately 57,200 acres. Petitioner's ranch is improved with various water developments, fences, corrals, loading chutes, barns, pipe lines, and general ranch improvements and equipment.

(b) Said ranch is located in a hot, semi-arid region, most of the rainfall occurring during three summer months. Due to climatic and geographical conditions, lands in said region are subject to erosion.

(c) During the taxable years involved petitioner received sums of money from the United States as follows:

1937	$3,586.89
1938	$3,247.74

(d) Said sums of money were received by petitioner pursuant to the provisions of the Soil Conservation and Domestic Allotment Act (Act of February 29, 1936, 49 Stat. 163) to reimburse it for expenditures made by it for participating during the years 1937 and 1938 in approved range-building practices under the Federal Range Conservation Programs for the Western Region of the United States.

(e) As an approved participant in said 1937 Range Conservation Program, petitioner completed the following work in connection with the improvement and rehabilitation of portions of eroded lands on its ranch:

(1) A dirt reservoir on land leased from the State was repaired and enlarged by petitioner in 1937 in order to control the natural drainage of the area and to prevent water from running off the higher areas so that rehabilitation of the public lands leased by petitioner and other lessees might thereby be promoted.

(2) In order to divert water from deep washes, spread it over theretofore barren land and into the dirt reservoir above men-

tioned, petitioner in 1937 built five additional structures on the State leased land included in its ranch. This erosion control project reclaimed approximately 3600 acres of State land leased by petitioner and materially lessened erosion on an adjacent tract [4] containing approximately 3600 acres. Said project also furthered the accumulation of water in the dirt reservoir above mentioned, thereby increasing the grazing area in the vicinity and lessening the concentration of grazing in other areas throughout the range occupied by petitioner and other ranches. The elimination of concentrated grazing is a material factor in the lessening of soil erosion.

(3) In order to prevent the concentration of cattle on portions of the range which might become overgrazed, two and three-fourths miles of drift fence were also constructed by petitioner in 1937 on State leased land.

(f) As an approved participant in said 1938 Range Conservation Program, petitioner completed the following work in connection with the improvement and rehabilitation of portions of eroded lands on its ranch:

(1) Five dirt reservoirs were repaired and rebuilt in 1938, two of which were located on land leased from the State. The remaining three reconstructed reservoirs were located on land owned by petitioner. Prior

to this work, the said reservoirs were dry during certain portions of the year, and, as a consequence, cattle would concentrate in the vicinity of other water supplies, resulting in portions of the range becoming a problem area because in time they might become overgrazed.

(2) An entirely new dirt reservoir was constructed in 1938. It was located on State leased land in an area that theretofore had not been available for grazing. By thus opening up a new grazing area concentrated grazing in other areas was lessened, with consequent elimination of soil erosion in such areas.

(3) Petitioner also constructed in 1938 a cement rubble masonry dam, containing 60 cubic yards of masonry. Said dam was located on State leased land and in a mountainous area theretofore not grazed by live stock. This was done with a view to preventing soil erosion by the dispersion of concentrated groups of grazing cattle from other water supply points.

(g) The said work done by petitioner under the Range Conservation Programs for 1937 and 1938 inured not only to the benefit of lands owned or leased by petitioner but also to the benefit of other lands in the same range or region. [5]

(h) In its participation in the Range Conservation Programs for 1937 and 1938, petitioner, in all respects, complied with the provisions of the aforementioned Soil Conservation and Domestic Allotment Act and the regulations issued thereunder. The payments made to petitioner, as set forth in Paragraph (c) above, were made on recommendation of the range examiner and on the approval of petitioner's application for said payments by the Pima County Range Conservation Committee. The amounts of said payments were arrived at by the use of a formula that took into consideration the acreage and vegetative density of petitioner's range land, said formula being devised by the Federal Government.

(i) In petitioner's books of account the cost of all said improvements has been treated as a capital item, carried in an account entitled "Improvements Under Federal Aid", and not charged to Profit and Loss account. The reimbursements of said costs, received from the United States as aforesaid, have been treated as credit to Capital Surplus.

(j) The cost of the work so done by petitioner in 1937 and 1938 exceeded the amounts so received from the United States.

(k) In his audit of petitioner's income tax returns, respondent has included in its income, subject to the Federal income tax, said amounts

aggregating $3,586.89 for 1937 and $3,247.74 for 1938.

(l) Petitioner is advised and therefore alleges: that no part of the said sums received constituted income taxable to it under the applicable Revenue Acts; that the said sums do not constitute income to petitioner, within the meaning of the Sixteenth Amendment to the Federal Constitution; and that nothing in the provisions of the applicable Revenue Acts, or the Soil Conservation and Domestic Allotment Act, requires or permits the inclusion of said sums in petitioner's taxable income for the years 1937 and 1938.

Wherefore, petitioner prays that the Board may hear this proceeding and determine that petitioner is liable to no deficiencies in income taxes for the years 1937 and 1938.

JOHN W. TOWNSEND
1366 National Press Bldg.,
Washington, D. C.
Attorney for Petitioner.

Of Counsel
CROMELIN, TOWNSEND, BROOKE & KIRKLAND [6]

State of Arizona
County of Pima—ss.

Carlos E. Ronstadt, being duly sworn, says that he is President of the petitioner above named, and that he is duly authorized to verify the foregoing

petition; that he has read the same and is familiar with the statements contained therein; and that the statements contained therein are true to the best of his knowledge, information, and belief.

CARLOS E. RONSTADT

Subscribed and sworn to before me this ..... day of July, 1940.

[Seal] .....

Notary Public [7]

EXHIBIT "A"

SN-IT-1

TREASURY DEPARTMENT
Internal Revenue Service
12th Floor,
U. S. Post Office and Court House,
Los Angeles, California.
Apr 20, 1940

Los Angeles
IT:LA
PB-90D

Baboquivari Cattle Company,
Santa Margarita Ranch,
Tucson, Arizona.

Sirs:

You are advised that the determination of your income tax liability for the taxable year(s) 1937 and 1938 disclose a deficiency of $1,220.06 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to Internal Revenue Agent in Charge, Los Angeles, California, for the attention of IT:LA:FC. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,
GUY T. HELVERING,
Commissioner,
By /s/ GEORGE D. MARTIN
Internal Revenue Agent in Charge.

Enclosures:
Statement.
Form of waiver. [8]

STATEMENT

IT:LA
PB-90D

Baboquivari Cattle Company,
Santa Margarita Ranch,
Tucson, Arizona.

Tax Liability for the Taxable Years Ended
December 31, 1937
and
December 31, 1938

	Year	Liability	Assessed	Deficiency
Income tax	1937	$1,490.97	$ 695.37	$ 795.60
Income tax	1938	797.56	373.10	424.46
Totals		$2,288.53	$1,068.47	$1,220.06

In making this determination of your income tax liability, careful consideration has been given to the reports of examination dated August 4, 1939, and December 28, 1939, to your protest dated September 2, 1939, and to the statements made at the conferences held on October 24, 1939, November 27, 1939, and January 20, 1940.

A copy of this letter and statement has been mailed to your representative, Mr. James M. Lawton, Valley National Bank Building, Tucson, Arizona, in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau. [9]

ADJUSTMENTS TO NET INCOME

Taxable year ended December 31, 1937

Net income as disclosed by return			$1,823.01
Additional income and unallowable deductions:			
(a)	Payments received from the United States	$3,586.89	
(b)	Loss disallowed	168.45	
(c)	Depreciation disallowed	1,336.18	
(d)	Error in inventory	1,000.00	
(e)	Adjustments of accounts	32.00	6,123.52
Net income adjusted			$7,946.53

EXPLANATION OF ADJUSTMENTS

(a) Payments amounting to $3,586.89 received by you in the taxable year from the United States Government under the Soil Conservation and Domestic Allotment Act constitute taxable income within the meaning of section 22(a), Revenue Act of 1936.

(b) The deduction of $168.45 for loss sustained upon an exchange of automobiles is disallowed in accordance with the provisions of section 112(b)(1) of the Revenue Act of 1936.

(c) The deduction for depreciation is disallowed to the extent of $1,336.18. Section 23(1), Revenue Act of 1936.

(d) The inventory of calves at the close of the taxable year was understated $1,000.00 due to a mathematical error, resulting in an understatement of income in the amount of $1,000.00.

(e) Miscellaneous adjustments of accounts, credited to capital surplus on your books, represent taxable income in the amount of $32.00.

You have signified your acceptance of the above adjustments except (a), and as a result of such acceptance the amount of $432.13 was assessed as a deficiency, which is taken into consideration in the computation of tax below. [10]

COMPUTATION OF INCOME TAX

Taxable year ended December 31, 1937

Normal Tax		
Taxable net income		$7,946.53
Normal-tax net income		$7,946.53
Normal tax:		
8% of $2,000.00	$160.00	
11% of 5,946.53	654.12	
Total normal tax		$ 814.12
Surtax on Undistributed Profits		
Taxable net income		$7,946.53
Less: Normal tax		814.12
Adjusted net income		$7,132.41
Undistributed net income		$7,132.41
Surtax:		
7% of $5,000.00	$350.00	
12% of 713.24	85.59	
17% of 1,419.17	241.26	
Total surtax		$ 676.85
Total income tax (normal tax and surtax)		$1,490.97
Income tax assessed (normal tax and surtax):		
Original, account No. 40552	$263.24	
Additional, Dec. 22, 1939, No. 529000	432.13	
Total assessed		695.37
Deficiency of income tax		$ 795.60

ADJUSTMENTS TO NET INCOME

Taxable year ended December 31, 1938

Net income as disclosed by return		$2,306.30
Additional income and unallowable deduction:		
(a) Payments received from the United States	$3,247.74	
(b) Depreciation disallowed	1,678.52	4,926.26
Total		$7,232.56
Additional deduction:		
(c) Error in inventory		1,000.00
Net income adjusted		$6,232.56

EXPLANATION OF ADJUSTMENTS

(a) Payments amounting to $3,247.74 received by you in the taxable year from the United States Government under the Soil Conservation and Domestic Allotment Act constitute taxable income within the meaning of section 22(a), Revenue Act of 1938.

(b) The deduction for depreciation is disallowed to the extent of $1,678.52. Section 23(1), Revenue Act of 1938.

(c) The inventory of calves at the beginning of the year was understated $1,000.00, resulting in an overstatement of income of $1,000.00.

You have signified your acceptance of the above adjustments except (a), and as a result of such acceptance the amount of $84.81 was assessed as a deficiency, which is taken into consideration in the computation of tax below. [12]

COMPUTATION OF INCOME TAX

Taxable year ended December 31, 1938

Taxable net income		$6,232.56
Amount subject to income tax		$6,232.56
Income tax:		
12½% of $5,000.00	$625.00	
14% of 1,232.56	172.56	
Total income tax		$ 797.56
Income tax assessed:		
Original, account No. 41117	$288.29	
Additional, Feb. 16, 1940, No. 529000	84.81	
Total assessed		373.10
Deficiency of income tax		$ 424.46

[Endorsed]: U.S.B.T.A. Filed Jul. 18, 1940. [13]

[Title of Board and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the calendar years 1937 and 1938; denies the remainder of the allegations contained in paragraph 3 of the petition.

4. Denies the allegations of error contained in subparagraph (a) of paragraph 4 of the petition.

5. (a) to (d), inclusive. Admits the allegations contained in subparagraphs (a) to (d), inclusive, of paragraph 5 of the petition.

(e) to (h), inclusive. Denies the allegations contained in subparagraphs (e) to (h), inclusive, of paragraph 5 of the [16] petition.

(i) Admits the allegations contained in subparagraph (i) of paragraph 5 of the petition.

(j) Denies the allegations contained in subparagraph (j) of paragraph 5 of the petition.

(k) Admits the allegations contained in subparagraph (k) of paragraph 5 of the petition.

(l) Denies the allegations contained in subparagraph (l) of paragraph 5 of the petition.

6. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

(Signed) J. P. WENCHEL,
FTH
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:
Alva C. Baird,
Division Counsel.
Frank T. Horner,
E. A. Tonjes,
Special Attorneys,
Bureau of Internal Revenue.

EAT/nm 8/29/40

[Endorsed]: USBTA Filed Sep. 17, 1940. [17]

[Title of Board and Cause.]

STIPULATION

It is hereby stipulated and agreed by and between the parties hereto that the facts hereinafter set forth may be taken and accepted by the Board of Tax Appeals at the trial of this proceeding as if fully proven by competent evidence, both parties reserving the right to introduce other and further evidence not inconsistent with the facts herein stipulated:

1. The petitioner, Baboquivari Cattle Company, is a corporation organized and existing under and by virtue of the laws of the State of Arizona and during 1937 and 1938 was engaged in the operation of a cattle ranch known as the Santa Margarita Ranch, comprising approximately 57,200 acres of land located in the southwest portion of Pima County, Arizona. Of the total acreage comprising the ranch 7,319 acres were owned outright by the petitioner, 45,880 acres were owned by the State of Arizona, and 4,000 acres were owned by the United States Government. It filed its Federal income and excess-profits tax returns for the years 1937 and 1938 with the Collecter of Internal Revenue for the District of Arizona.

2. The land owned by the State of Arizona was held by petitioner pursuant to certain Grazing Leases executed by petitioner and the State Land Department of the State of Arizona, pursuant to the laws of that State, [18] each lease covering a

specified parcel of land and providing for a term certain. The land owned by the United States was held by petitioner pursuant to provisions of the Taylor Grazing Act of June 28, 1934 (48 Stat. 1269), as amended.

3. During 1937 and 1938 the petitioner made certain improvements to the ranch under the provisions of the Soil Conservation and Domestic Allotment Act (Act of February 29, 1936, 49 Stat. 163) for which it received payments or reimbursements from the United States in 1937 in the amount of $3,586.89 and in 1938 in the amount of $3,247.74.

4. In the petitioner's books of account the cost of the above improvements was not charged to profit and loss account but rather was treated as a capital item and carried into an asset account entitled "Improvements under Federal Aid". The amounts received by the petitioner in 1937 and 1938 as reimbursements for the cost of said improvements were treated as a credit to capital surplus.

5. Of the total amount received in 1937 none represented reimbursements or payments for improvements made on land owned outright by the petitioner, $3,586.89 on land owned by the State of Arizona, and none on land owned by the United States Government. Of the total amount received in 1938 $899.10 represented reimbursements or payments for improvements made on land owned outright by the petitioner, $2,348.64 on land owned by the State of Arizona, and none on land owned by the United States Government.

6. In the audit of petitioner's returns for 1937 and 1938 the Commissioner included the entire amounts so received in its gross income for those years.

7. It is further stipulated and agreed that the affidavit of Carlos E. Ronstadt, executed February 1, 1941, attached hereto and marked Exhibit 1, [19] may be received in evidence in this case with like effect as though the said Carlos E. Ronstadt personally appeared before the Board and testified to the matters and facts set forth in said affidavit, and that the four exhibits attached to the said affidavit of Carlos E. Ronstadt marked Exhibits "A", "B", "C", and "D" may be received in evidence in this case as petitioner's Exhibits.

8. The petitioner's ranch is situated on the watershed of the Gila River, a tributary of the Colorado River.

(Sgd) JOHN W. TOWNSEND,
Attorney for Petitioner.

(Sgd) J. P. WENCHEL,
RES
Chief Counsel, Bureau of Internal Revenue,
Attorney for Respondent.

[Endorsed]: USBTA Filed Nov. 5, 1941. [20]

[Title of Board and Cause.]

AFFIDAVIT OF CARLOS E. RONSTADT

State of Arizona,
County of Pima—ss.

Carlos E. Ronstadt, being first duly sworn, deposes and says:

That he is now and since prior to 1936 has been President of the Baboquivari Cattle Company, a corporation organized and existing under the laws of the State of Arizona, and by reason thereof is personally familiar with the matters and facts hereinafter set forth.

Said Baboquivari Cattle Company is the petitioner in the above-entitled proceeding. It is now and at all times material hereto was engaged in raising cattle and livestock for sale on its ranch properties located in the southwest part of Pima County, Arizona, said ranch properties consisting of approximately 57,200 acres. There is attached hereto, marked Exhibit "A", a map of said ranch prepared by engineers of the Agricultural Adjustment Administration, United States Department of [21] Agriculture.

Pursuant to the provisions of the Soil Conservation and Domestic Allotment Act, as amended, and to regulations promulgated thereunder by the Secretary of Agriculture, known as the "1937 Agricultural Conservation Program—Western Region Bulletin No. 101-Arizona", and amendments thereto, petitioner corporation made application for range-

building payments provided by such laws and regulations. Such application was approved, there being attached hereto, marked Exhibit "B", the original of a letter dated July 16, 1937, from C. B. Brown, Secretary, Pima County Agricultural Conservation Association, to Carlos Ronstadt, President, Baboquivari Cattle Company, authorizing the company to proceed with certain range improvements. There is also attached hereto, marked Exhibit "C", duplicate original of "Report on Examination of Range Land" bearing certificate of Range Examiner, W. K. Koogler, dated July 7, 1937, recommending and outlining the projects to be undertaken on the company's ranch, and including the company's application for permission to carry out the same.

Pursuant to the authorization set forth in said letter of July 16, 1937, and to supplemental instructions thereafter received, said corporation in the year 1937 constructed and completed the following work in connection with the improvement and rehabilitation of portions of eroded lands on its said ranch:

(1). A reservoir or dirt tank on land leased by the corporation from the State of Arizona was repaired and enlarged in 1937 in order to [22] control the natural drainage of the area, and to prevent water from running off the higher areas, so that rehabilitation of the public lands leased by petitioner and other lessees might thereby be promoted. Said reservoir was

approximately 100 yards in diameter, with side retaining walls permitting an approximate depth of eighteen feet of water.

(2). In order to divert water from deep washes and spread same over theretofore barren land and into the reservoir above mentioned, the corporation in 1937 also built several dikes or embankments on land leased from the State. These erosion control projects reclaimed approximately 3600 acres of State land leased by the corporation and materially lessened erosion on adjacent tracts containing approximately 3600 acres. Said projects also furthered the accumulation of water in the reservoir above mentioned, and thereby increased the grazing area in the vicinity, with consequent lessening of the concentration of grazing in other areas throughout the range occupied by petitioner and other ranches.

(3). In order to prevent the concentration of cattle on portions of the range which might become over-grazed, two and three-fourths miles of drift fence were also constructed by the corporation in 1937 on lands leased from the State.

Upon inspection and approval of said construction work by officials of the Department of Agriculture, petitioner corporation was paid by the United States Government, pursuant to said laws and regulations, the sum of Three Thousand Five Hundred Eighty-six and 89/100 Dollars ($3,586.89). Said

amount exceeded the maximum of Three Thousand Four Hundred [23] Eighty-Seven and 50/100 Dollars ($3,487.50) stated in said letter of July 16, 1937, by reason of the fact that additional funds were thereafter made available for the promotion of the 1937 range conservation program in the State of Arizona.

Petitioner corporation also made application for range-building payments under the 1938 Federal Range Conservation Program—Western Region, pursuant to the laws and regulations providing therefor, and said application was approved. There is annexed hereto, marked Exhibit "D", duplicate original copy of "Report of Approved Range Building Practices (1938 Range Conservation Program—Western Region)" issued to Baboquivari Cattle Company, dated October 24, 1938, and signed by Carl E. Teeter, Executive Officer of the State Committee.

Pursuant to said report and the authorization therein contained, petitioner corporation, during the year 1938, completed the following work in connection with the improvement and rehabilitation of portions of eroded lands on its ranch:

(1). Five large reservoirs or earthen tanks were repaired and rebuilt in 1938, two of which were located on land leased from the State. The remaining three reconstructed reservoirs were located on land owned by the corporation. Prior to this work, the said reservoirs were dry during certain portions of the year, and,

as a consequence, cattle would concentrate in the vicinity of other water supplies, resulting in portions of the range becoming a problem area because in time it might become overgrazed. [24]

(2). An entirely new reservoir, or earthen tank, was constructed in 1938. This provided for impounding water with an area of approximately 250 by 400 feet and an approximate depth of 10 feet. This involved construction of a dam with a base approximately 30 feet and top 10 feet in thickness. It was located on land leased from the State of Arizona in an area that theretofore had not been available for grazing. By thus opening up new grazing areas, concentrated grazing in other areas was lessened, with consequent elimination of soil erosion due to possible overgrazing.

(3). The corporation also constructed in 1938 a cement rubble masonry dam containing approximately 60 cubic yards of masonry. Said dam was located on land leased from the State in a mountainous area theretofore not grazed by livestock. This was erected with a view to preventing soil erosion by the dispersion of concentrated groups of grazing cattle from other water supply points.

Upon inspection by Government officials and approval of the work completed by the company in 1938, it received from the United States Government, pursuant to said laws and regulations, the

sum of Three Thousand Two Hundred Forty-seven and 74/100 ($3,247.74).

In the region in which the petitioner's ranch is located, soil erosion has resulted in great part because of overgrazing of lands, resulting in the elimination of vegetation which would normally hold the soil in place during the heavy rains which are usually concentrated in the summer months of the year. For many years neither the Federal [25] Government nor the State of Arizona promoted soil conservation programs, nor provided restrictions on grazing upon public lands. The range programs adopted in recent years have tended to eliminate over-concentration of grazing. However, it will take many years and a carefully planned program of soil erosion control to rebuild the ranges depleted and eroded through lack of foresight and planning in former years.

The construction of earthen reservoirs and diversion dikes in connection therewith, and the construction of rubble masonry dams in mountainous areas not only make available permanent supplies of water for stock, thereby spreading the grazing livestock over a larger area and maintaining a more constant ground covering, which is a decided factor in the prevention of soil erosion by rapid run-off of water, but also retard the flow of water and allow uplands to absorb more moisture, thereby serving the twofold purpose of prevention of erosion in lowlands and the spreading of livestock in the uplands.

The said work done by petitioner corporation under the Range Conservation Programs for 1937 and 1938 inured not only to the benefit of lands owned or leased by it but also to the benefit of lands in the same range or region, owned or leased by other persons or corporations.

The cost to it of the construction work so done by petitioner corporation in each of the years 1937 and 1938 [26] exceeded the amounts which it received in each of said years from the United States as hereinbefore set forth.

The amounts so received were only approved for payment after inspection by Government officials and after careful measurement by them of the quantities of fill or excavation, and the number of feet of fence, said payments being arrived at by allowing the amounts per cubic yard prescribed by the regulations, or the amounts allowed per rod for fence construction.

CARLOS E. RONSTADT

Subscribed and sworn to before me this 1st day of February, 1941.

G. I. LEWIS,
Notary Public.

My commission expires: January 10, 1945. [27]

[Title of Board and Cause.]

Docket No. 103848. Promulgated June 16, 1942.

Benefit payments made by the United States for carrying out approved range improvement practices under the Soil Conservation and Domestic Allotment Act are includable in gross income.

Lloyd Fletcher, Jr., Esq., and John W. Townsend, Esq., for the petitioner.

E. L. Corbin, Esq., for the respondent.

OPINION

Mellott: The Commissioner made several adjustments to the net income shown by petitioner's returns for 1937 and 1938 and determined deficiencies in income tax in the respective amounts of $795.60 and $424.46. The sole error charged in the petition is the inclusion in gross income of $3,586.89 for 1937 and $3,247.74 for 1938, these being the amounts received from the United States under the Soil Conservation and Domestic Allotment Act.[1] All of the facts have been stipulated, admitted in the pleadings, or shown in documents received in evidence without objection and are found accordingly.

Petitioner, an Arizona corporation engaged in the operation of a cattle ranch and keeping its books upon the accrual basis, filed its returns with

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[1]Act of April 27, 1935 (49 Stat. 163), as amended by Act of February 29, 1936 (49 Stat. 1148).

the collector of internal revenue for the district of Arizona. The ranch comprises 57,200 acres of land in Pima County, Arizona, 45,880+ being owned by the state, 4,000 by the United States and 7,319+ by petitioner. During the taxable years the land owned by the state was held by petitioner under grazing leases duly executed under the laws of Arizona for terms of from five to ten years and the land owned by the United States was held by petitioner under the provisions of the Taylor Grazing Act of June 28, 1934 (48 Stat. 1296), as amended. The land is in a hot, semiarid region in the watershed of [34] the Gila River, a tributary of the Colorado River. The major portion of the rainfall occurs during three summer months and because of climatic and geographical conditions the lands owned or held by petitioner and surrounding lands are subject to substantial erosion.

During the taxable years petitioner constructed or rebuilt on the ranch some dirt reservoirs and earthen tanks, constructed a rubble masonry dam, built two miles of drift fence, deepened a well, and developed a spring or seep. Before these improvements were undertaken a range grazing examiner, working in conjunction with the Pima County Range Conservation Committee, had made a survey of petitioner's ranch and a report recommending that the improvements be made. The first report was approved by the committee on or about July 16, 1937. On that date the committee advised petitioner in writing: "Upon notification

by you * * * that one or more of these recommended improvements have been completed, the County Committee will inspect same and upon approval, will submit to you an application to be signed for benefit payment." The letter also advised petitioner, in accordance with the Soil Conservation and Domestic Allotment Act, supra, and the regulations issued thereunder:[2] "Number of animal units 2325 which times $1.50 per head, will enable you to earn a maximum payment of $3,487.50." Substantially the same procedure was followed in 1938, the total allowance, computed upon the number of acres and number of animal units, being $3,247.74.

Upon completion of a portion of the work in 1937 the contemplated notification was given, application was filed and approved, and payment was authorized and made to petitioner in the amount of $3,586.89. Upon completion of the remainder of the work in 1938 payment was made in the amount of $3,247.74. The cost of the work in each year exceeded the amounts received by petitioner from the United States. In petitioner's books of account the cost of the improvements was not charged to profit and loss, but was treated as a capital item and carried into an asset account en-

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[2]Western Region Bulletin No. 101, Arizona, Federal Register Feb. 26, 1937, p. 345; W. R. B. Arizona Supp. I, Federal Register, June 5, 1937, p. 1141; W. R. B. 101, Arizona Supp. II, Federal Register July 27, 1937, p. 1554.

titled "Improvements under Federal Aid." The amounts received by petitioner in the taxable years were treated as credits to capital surplus. In its returns of income the amounts were shown as carried upon petitioner's books; but neither was included in its gross income. The Commissioner added each of them to the net income reported.

All of the improvements in 1937 were made upon land owned by the State of Arizona and held by petitioner under lease. Of the total amount received by petitioner in 1938, $899.10 (in the language of [35] the stipulation) "represented reimbursements or payments for improvements made on land owned outright by the petitioner, $2,348.64 on land owned by the State of Arizona, and none on land owned by the United States Government." While we have found all of the facts to be as stipulated, we think it is more accurate to say that benefit payments were received by petitioner in the amounts shown above for carrying out the range improvement practices recommended by the range examiner and approved by the Pima County Agricultural Conservation Association in accordance with the regulations prescribed by the Secretary of Agriculture under the Soil Conservation and Domestic Allotment Act, supra. So much, then, for the basic facts.

The Act of April 27, 1935, (49 Stat. 163) directed the establishment of an agency in the Department of Agriculture to be known as the "Soil

Conservation Service" and provided that the Secretary of Agriculture should assume all obligations incurred by the Soil Erosion Service prior to its transfer to the Department. Congress "recognized that the wastage of soil and moisture * * * resulting from soil erosion, is a menace to the national welfare" and declared its policy to be "to provide permanently for the control and prevention of soil erosion and thereby to preserve natural resources, control floods, prevent impairment of reservoirs, and maintain the navigability of rivers and harbors, protect public health, public lands and relieve unemployment * * *." It therefore authorized the Secretary of Agriculture to conduct surveys, investigations, and research relating to the character of soil erosion and the preventive measures needed, to carry out preventive measures, and:

> (3) To cooperate or enter into agreements with, or to furnish financial or other aid to, any agency, governmental or otherwise, or any person, subject to such conditions as he may deem necessary, for the purposes of this Act.

As a condition to extending any benefits under the act to lands not owned by the United States the Secretary of Agriculture was authorized to acquire: (1) the enactment and reasonable safeguards for the enforcement of state and local laws imposing suitable permanent restrictions on the use of the lands and otherwise providing for the pre-

vention of soil erosion; (2) agreements or covenants as to the permanent use of such lands; and (3) contributions in money, services, materials, or otherwise, to any operations conferring such benefits. He was also authorized to secure the cooperation of any governmental agency, to continue employees of the organization theretofore established for the purpose of administering the provisions of the act with relation to the prevention of soil erosion, and to expend the funds theretofore appropriated for such purpose. [36]

The excerpts from the report of the Senate Committee on Agriculture and Forestry shown in the margin[3] indicate the magnitude of the problem and the reason for the enactment of the legislation.

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[3]Recognizing that, unless soil erosion can be controlled on farm, grazing, and forest lands, the prosperity of the United States cannot be permanently maintained, the bill provides for the coordination of all Federal activities with relation to soil erosion.

Heretofore, soil-erosion control has been among several groups in the different Departments. The present bill coordinates all of these groups and places the control under the Secretary of Agriculture. Experiences of recent storms, both flood and wind, demonstrate the necessity to prevent wastage of soil, the conservation of water, and the control of floods. The silting of reservoirs, the maintaining of the navigability of rivers and harbors, the protection of public lands, all justify Federal responsibility for the carrying out of a national erosion-control program.

Vast areas of agricultural lands are threatened with abandonment and the occupants thereof are

The Soil Conservation Act was amended February 29, 1936, by the addition of several new sections and it became the "Soil Conservation and Domestic Allotment Act." (49 Stat. 1148.) The most substantial change was through the addition of sections 7 and 8. Section 7, as explained in Report No. 1973 of the House Committee on Agriculture, 74th Cong., 2d sess., provided for Federal grants to the states to enable them to carry out plans developed by them to effectuate any one or more of the following purposes:

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daily increasing the numbers on Federal relief rolls to the extent that this problem alone warrants an extensive Federal erosion-control program.

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The aid authorized in this subsection will be necessary because, in general, the owner of private lands cannot bear the entire cost of controlling the erosion thereon. He has neither the technical knowledge nor the financial resources. Over tremendous areas, land destruction has proceeded to the point where it would be impossible to persuade or force the owners to assume the entire burden of control, nor would it be just to do so. Fundamentally, they have not been responsible for the erosion which has occurred. In the disposal of the public domain, settlers were encouraged to acquire the public lands and to cultivate them. With the transfer of ownership went no restrictions, instructions, or advice as to methods under which the land should be used in order to protect it from erosion.

Acting in good faith, the settlers used their land in the light of the best information available. Since it was not the initial fault of the settler that his land became subject to erosion, it would not be

(1) Preservation and improvements of soil fertility;

(2) Promotion of the economic use of land;

(3) Diminution of exploitation and of ununprofitable use of national soil resources; [37]

(4) Provision for and maintenance of a continuous and stable supply of agricultural commodities adequate to meet domestic and foreign consumer requirements at prices fair to producers and consumers; and

(5) Reestablishment and maintenance of farmers' purchasing power.

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right to require him to bear the entire burden of repairing damage done or of preventing future damage. Furthermore, the interest of the Nation in Controlling erosion far exceeds that of the private landowners. An individual may destroy his land, move away, obtain a position somewhere else, accumulate capital, and purchase new land. For the Nation, land destroyed is land gone forever. This drain on the national resource is not immediately fatal, but, if the destruction continues unchecked, the time will come when remaining land resources will be insufficient to support our population on an adequate standard of living. The cost to the Nation of such changes would be incalculable. Moreover, erosion directly threatens vast Federal investments in dams and channels and annually requires the expenditure of large sums for dredging operations. The only practical method of eliminating these hazards and costs is to control the erosion on private lands, and it would not be equitable to require the owner of these lands to make expenditures for the protection of Federal investments.

* * * * * * *

Each state was left free to accept or refuse the benefits and it was contemplated that no citizen of a state should have any relation, contractual or otherwise, with the Federal Government.

As a temporary expediency the Secretary of Agriculture, under section 8, was given power to make payments of grants or other aid to agricultural producers determined by him to be fair and reasonable in connection with the effectuation of the purposes specified in section 7, measured by: (1) the treatment or use of their land or a part thereof for soil restoration, soil conservation or the prevention of erosion; (2) changes in the use of their land; (3) a percentage of their normal production of any one or more agricultural commodities designated by the Secretary equaling the percentage of the normal national production of such commodity or commodities required for domestic consumption; or (4) any combination of the above. In determining the amount of any payment or grant measured by (1) or (2) the Secretary was required to take into consideration the productivity of the land affected by the farming practices adopted during the year with respect to which the payment was made. He was authorized to utilize county and community committees of agricultural producers, the agricultural extension service, and other approved agencies in carrying out the provisions of the act, but he was specifically denied the power "to enter into any contract binding upon any producer or to acquire any land or

any right or interest therein." In administering section 8 the Secretary was required in every practical way to encourage and provide for soil conserving and soil rebuilding practices rather than the growing of soil depleting commercial crops. To carry out the purposes of sections 7 and 8 there was authorized to be appropriated for any fiscal year an amount not in excess of $500,000,000.

Under date of January 14, 1937, the Seccretary, pursuant to the authority vested in him under section 8 of the act promulgated regulations under which payments would be made to farmers, tenants, ranch operators, sharecroppers, etc., in the State of Arizona. A ranch operator was defined to be "a person who as owner, cash tenant, or share tenant operates or a person who acts in similar capacity in the operation of a ranching unit." A ranching unit was "all range land which is used by the ranch operator as a single unit in producing range live stock with farm machinery, work stock and labor, substantially separate from that of any other range land." A range building payment was stated to mean "a payment for the carrying [38] out of approved range building practices" and a range building allowance was defined as "the largest amount for any ranching unit which may be earned as a range building payment on such ranching unit." Animal unit was defined as "one cow, one horse, 5 sheep, 5 goats or the equivalent thereof" and grazing capacity or range land was stated to mean "that number of animal

units which such land will sustain on a twelve-month basis over a period of years without injury to the range forage, tree growth or watershed." (Western Region Bulletin, No. 101, Arizona, supra.)

Under part IV of the regulations the rates and conditions of range building payments were set out. As particularly applicable to the presently stipulated facts they were: 15 cents per cubic yard of fill or excavation for constructing earthen pits or reservoirs with adequate spillways; $1 per linear foot for drilling or digging a well; $50 for digging out a spring or seep and protecting the source from trampling; 30 cents per rod for constructing cross fences or drift fences; and 3 cents per linear foot for the establishment of fire guards. Under section 2 of part IV of the regulations the range building allowance for any ranching unit was to be "equal to $1.50 times the grazing capacity of the range land in the ranching unit."

Application for range building payments could be made only by ranch operators and payments were to be made only upon application filed with the county committee. The grazing capacity for each ranching unit was to be established only upon a report submitted by the range examiner who, in examining the range and making his report thereon, was required to take into consideration: (a) composition, palatability, and density of growth; (b) climatic fluctuations; (c) distribution

and character of watering facilities; (d) topographic and cultural features; (e) classes of live stock; (f) presence or absence of rodents and poisonous plant infestations; and (g) previous use.

The regulations were amended June 3, 1937 (W. R. B. No. 101, Arizona, Supplement I, supra) to provide that payment be made for carrying out on range land in 1937 such range building practices as were approved by the county committee for the ranching unit prior to their institution, provided the payments did not exceed the range building allowance for the ranching unit. They were further amended under date of July 23, 1937 (W. R. B. 101, Arizona, Supplement II, Federal Register, July 27, 1937, p. 1554) in particulars not presently important.

Rather extended reference has been made to the act and regulations under which the payments in issue were made for two reasons: First, because this is the first proceeding before the Board in which the taxability of such payments has been in issue; and second, because, [39] notwithstanding the stipulation of the parties to the effect that the payments were "reimbursements or payments for improvements made on land owned outright by petitioner * * * or by the State of Arizona", we feel that they were nothing but benefit payments for carrying out approved range improvement practices recommended by the range examiner and approved by the county conservation committee. With

this background and acting upon the assumption that our question is essentially whether benefit payments are income to the recipient, we give consideration to the several contentions made by petitioner upon brief, though not in the order presented by it.

May the payments be construed to be gifts and therefore exempt from taxation under section 22 (b) (3) of the Revenue Act of 1936? Petitioner urges that they should be, pointing out that the Secretary of Agriculture had no power under the act to "enter into any contract binding upon any producer", that the United States received no direct consideration in goods or services for the payments made, and that the act itself refers to the payments as "grants." The only case cited is United States v. Hurst, 2 Fed. (2d) 73. In that case the United States District Court for the District of Wyoming followed Union Oil Co. v. Smith, 249 U. S. 337, which recognized that a locator and discoverer of mineral rights upon vacant lands of the United States had a possessory right in the land, capable of conveyance, inheritance or devise, and held that the acquisition of such a right under the United States statutes partook "more of the nature of a gift than that of any other method of acquiring title to property known to the law." It also held that if Congress had desired to exclude from its exemption of gifts any particular kind it would have so declared.

It may be assumed for present purposes that the conclusion of the Court was correct under the facts before it; but we do not believe that the payments now in issue can be construed to be gifts. Under the Soil Conservation and Domestic Allotment Act it was not intended that the Government should make "a voluntary transfer of real or personal property without any consideration", "a donation", "a present", or that it should "voluntarily bestow something of value without expectation of return." The very theory of the legislation was that the Government and the landowner or tenant should cooperate in preventing soil erosion, the Government intending, not to bind a landowner or tenant to make any particular improvement, but to give him a "benefit payment", if earned, after inspection of the completed work was required to be performed voluntarily and that the Secretary of Agriculture was without power to enter into any binding contracts with the owner or operator before the completion of the work, is not sufficient, in our [40] judgment, to make the payments mere gifts. We hold, therefore, that the amounts in issue may not be excluded from gross income under section 22 (b) (3), supra.

The taxation of the payments to it, says the petitioner, would pro tanto reduce the benefits granted by the Soil Conservation and Domestic Allotment Act and thus defeat the very purpose of Congress. This, it contends, "argues strongly that

the payments were not intended by Congress to be subject to taxation as income." The only cases cited in support of this contention are those holding that tax-imposing statutes are to be construed strictly against the Government and all doubt resolved in favor of the taxpayer. Gould v. Gould, 245 U. S. 151; Crooks v. Harrelson, 282 U. S. 55. In our judgment the cited cases are not applicable. Petitioner's assertion that this is a case where there is a presumption against the taxability of the amounts received is not supported by any authorities, nor does it point to any specific statute allowing an exemption from tax. The act under which the payments were made was passed while the income tax laws were in full force and effect. It must be presumed that Congress was aware of their provisions. Since it did not see fit to incorporate in the act a provision exempting benefit payments, the conclusion that it intended them to be taxed is inescapable. Cf. Pacific Co. Ltd. v. Johnson, 285 U. S. 480; Sun-Herald Corporation v. Duggan, 73 Fed. (2d) 298; United States v. Stewart, 311 U. S. 60.

The briefs of the parties are largely devoted to a discussion of the rule enunciated by the Supreme Court in Edwards v. Cuba Railroad Co., 268 U. S. 628, and its applicability to the stipulated facts. Stated generally, it is that a contribution to the capital assets of a railroad company in order to induce construction and operation of rialroads for

the service of the public, does not constitute income to the recipient within the meaning of the Sixteenth Amendment. The cited case has been followed many times by the courts and this Board. In Liberty Light & Power Co., 4 B. T. A. 155, citizens of a community, desiring to obtain electric service, transferred to the taxpayer transmission lines which they had constructed. In Texas & Pacific Railway Co. v. United States, 52 Fed. (2d) 1040; affirmed on another issue, 286 U. S. 285, and Kauai Railway Co., Ltd., 13 B. T. A. 686, contributions were made to railroad companies by business concerns for the construction of spur or side tracks and for other construction work. In Chicago & Northwestern Railway Co. v. Commissioner, 66 Fed. (2d) 61; certiorari denied, 290 U. S. 672, the taxpayer received an allowance from the Government for undermaintenance of its railroad during Federal control. In Frank Holton & Co., 10 B. T. A. 1317, property to be used as a factory was conveyed to the taxpayer to induce it to locate in that city, and in Arkansas Compress Co., 8 B. T. A. 155, contributions of land and cash [41] were made to the taxpayer to induce it to erect and operate cotton compresses and warehouses. In each case it was held that the taxpayer was not in receipt of taxable income. See also Great Northern Railway Co., 8 B. T. A. 225; affd., 40 Fed. (2d) 372; certiorari denied, 282 U. S. 855; Baltimore & Ohio Railroad Co., 30 B. T. A. 194;

Decatur Water Supply Co. v. Commissioner, 88 Fed. (2d) 341; Valley Waste Disposal Co., 38 B. T. A. 452; and Detroit Edison Co., 45 B. T. A. 358 (on appeal, C. C. A., 6th Cir.).

But while the rule of the cited case has been followed many times, it has been found to be inapplicable to many payments made by the sovereign to a taxpayer. The Court of Claims, in Texas & Pacific Railway Co. v. United States, supra, citing a number of cases decided by this Board in which it was held that amounts received by railroad companies under the provisions of the Transportation Act to make good an operating deficit for the six-month period after termination of Federal control were income (Gulf, Mobile & Northern Railroad Co., 22 B. T. A. 233; affd., 293 U. S. 295, and others), came to the same conclusion, though the railroads were relying upon Edwards v. Cuba Railroad Co. The Supreme Court affirmed, saying —"The sums * * * were not subsidies or gifts." Texas & Pacific Railway Co. v. United States, supra. See also Continental Tie & Lumber Co. v. United States, 286 U. S. 290. The amounts paid to railroad companies as just compensation for the taking and use of their properties during Federal control were also held to be income (Kansas City Southern Railway Co. v. Commissioner, 52 Fed. (2d) 372; certiorari denied, 284 U. S. 676, affirming on this point 16 B. T. A. 665), although the taxpayers relied upon the rule of the Cuba Railroad

Co. case. In Burke-Divide Oil Co. v. Neal, 73 Fed. (2d) 857; certiorari denied, 295 U. S. 740, the amount received from the United States through the Secretary of the Interior, representing the taxpayer's equitable portion of an amount which had been accumulated and impounded pending termination of litigation in connection with oil and gas claims which, in good faith, had been developed in the bed of the Red River, was held to be income. Under somewhat similar facts the same conclusion was reached in Obispo Oil Co. v. Welch, 85 Fed. (2d) 860, the case, however, being reversed by the Supreme Court (301 U. S. 190) upon other grounds. In Marine Transport Co. v. Commissioner, 77 Fed. (2d) 177, affirming Marine Transport Co., 28 B. T. A. 566, it was held that an award made to the petitioner by the Mixed Claims Commission on account of the destruction of a schooner in 1917 was not, as contended by it, a gratuity or bounty but compensation for property destroyed. Payment of the sum of $23,000 by the State of Maryland to a ferry company was held, in Helvering v. Claiborne-Annapolis Ferry Co., [42] 93 Fed. (2d) 875, to be compensation for operation of the ferry and hence includable in gross income. A shipping company, which had received a very favorable contract for the carrying of the mails and which had agreed to impound a portion of its earnings to be expended for additional vessels, was required to include in income the amounts impounded during the taxable years, notwithstanding

its contention that they were either parts of a Government subsidy usable only for capital purposes or not income within the definition in Eisner v. Macomber, 252 U. S. 189. Lykes Bros. Steamship Co., 42 B. T. A. 1935; affd., 126 Fed. (2d) 725. Edwards v. Cuba Railroad Co. was cited and relied upon in each of the cited cases but found to be inapplicable.

In the preceding paragraphs reference has been made to practically all of the cases in which Edwards v. Cuba Railroad Co. has been cited or discussed. They indicate that the doctrine has been sparingly applied. It has been pointed out above that the payments in issue were made for cooperating in the soil conservation program. They were denominated "benefit payments." They were made under the same law and regulations that payments were made for refraining from raising cotton or sugar beets, for devoting a portion of the acreage to the raising of leguminous crops, taking steps to eradicate rodents and noxious weeds, furrowing on the contour, withholding land from grazing, or following out other approved practices for building up the soil and preventing erosion. It is true that the Government had not bound the landowners, by contract, to perform any of the practices; but it, by its regulations and adoption of the program, held out to them the incentive that payment would be made if the practices were followed out. In other words, the Government was in somewhat the same situation that a private individual would be

under an outstanding offer of purchase or sale at a given price. It told the landowners what was desired and agreed to pay those who complied with the established practices. Petitioner complied and received the payments. They, in our judgment, were income. Cf. Salvage v. Commissioner, 76 Fed. (2d) 112.

The bookkeeping entries made by petitioner following receipt of the payments are not determinative, if they have any significance whatever in the instant proceeding. No doubt its capital improvements were enhanced in value; but so would they have been if petitioner had elected, for instance, to expend money in eradicating rodents or noxious weeds, planting leguminous crops, furrowing on the contour, or following most any of the approved practices. We can not believe Congress ever intended that all such payments should be wholly exempted from tax. Nor are we persuaded that a different rule should be applied because, as suggested by petitioner, the [43] United States "admits responsibility for the conditions which necessitate the rehabilitation work." This is no doubt a real justification for the expenditure by the Government; but it does not justify a failure to tax one who is enriched thereby.

At the risk of unnecessarily extending this discussion it may be pointed out that if the payments to petitioner are not taxed as income in the year of receipt it will receive even more favorable treat-

ment than will be received by manufacturers of essential war materials and commodities, who are cooperating with the Federal Government in the present emergency. They, under Title III—Amortization Deduction, Second Revenue Act of 1940 (sec. 124, I. R. Code) and articles 19.124–1 to 19.124–9, Regulations 103, as amended by T. D. 5016, may amortize, over a 60-month period, the cost of facilities constructed by them for the manufacture of essential war commodities; but in determining the adjusted basis of such facilities all amounts received "in connection with * * * [their] agreement to supply articles for national defense, though denominated reimbursements for all or a part of the cost of an emergency facility, are not to be treated as capital receipts but are to be taken into account in computing income * * *." (Art. 19.124–6, Regulations 103.) In petitioner's returns of income it included, in its depreciable assets, "Improvements under Federal Aid $6978.52" and deducted as depreciation, a portion thereof based on the estimated life of the property. The claimed deduction has been allowed. It is apparent, therefore, that petitioner will recover, through amortization, depreciation and obsolescence, its total capital investment in the property. If the amounts received from the Government are not included in income, it, in effect, will have a double deduction. In the absence of specific legislation, it should not be assumed Congress intended that recipients of

benefit payments be singled out for such preferential treatment.

The Commissioner, in our judgment, committed no error in including the amounts in issue in petitioner's income. Since this is the only adjustment contested,

Decision will be entered for the respondent.

Reviewed by the Board. [44]

United States Board of Tax Appeals
Washington

Docket No. 103848

BABOQUIVARI CATTLE COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Board, as set forth in its opinion promulgated June 16, 1942, it is

Ordered and Decided: That there are deficiencies in income tax for the years 1937 and 1938 in the respective amounts of $795.60 and $424.46.

Enter:

(S) ARTHUR MELLOTT,
[Seal] Member.

Entered June 16, 1942. [45]

In the United States Circuit Court of Appeals
for the Ninth Circuit

B. T. A. Docket No. 103848

BABOQUIVARI CATTLE COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REVIEW

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Now comes the petitioner, Baboquivari Cattle Company, by John W. Townsend, its attorney, and respectfully shows to this Honorable Court as follows:

I.

The petitioner is an Arizona corporation with principal office at Santa Marguerita Ranch, Tucson, Arizona, and files this petition for review in its own right. The respondent, hereinafter referred to as the Commissioner, is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States.

II.

The controversy involves the proper determination of petitioner's Federal income tax liability for

the years 1937 and 1938. In a deficiency notice dated April 20, 1942, respondent determined a deficiency of $795.60 in income tax of the petitioner for the calendar year 1937 and a deficiency of $424.46 in income tax of the petitioner for the calendar year 1938. From such determination the petitioner duly prosecuted an appeal to the [46] United States Board of Tax Appeals. The case was heard by the Board in due course at Washington, D. C., on November 5, 1941. All of the facts were stipulated by the parties, admitted in the pleadings, or shown in certain documentary exhibits received in evidence without objection. On June 16, 1942, the Board promulgated its findings of fact and opinion sustaining the respondent's determination, and on June 16, 1942 entered its decision, pursuant to said opinion, determining that there are deficiencies in income taxes for the years 1937 and 1938, in the respective amounts of $795.60 and $424.46. On July 15, 1942, the petitioner filed its Motion for Rehearing and To Vacate Decision, together with its brief in support of said motion. Said motion was denied by the Board on July 20, 1942.

III.

Petitioner seeks a review of the Board's said decision by the United States Circuit Court of Appeals for the Ninth Circuit, pursuant to the provisions of Section 1142 of the Internal Revenue Code. This Court has jurisdiction of the proceeding by virtue of the provisions of Section 1141 of

the Internal Revenue Code, the returns of tax, in respect of which respondent determined the contested deficiencies, having been filed in the Office of the Collector of Internal Revenue for the State of Arizona, at Phoenix, Arizona.

IV.

The controversy in this case arises by reason of the following circumstances:

The petitioner is, and during the taxable years, was engaged in the operation of a cattle ranch known as the Santa Marguerita Ranch, comprising approximately 57,200 acres of land located in Pima County, Arizona. Of the total acreage 45,880 acres were owned by the State of Arizona, 4000 acres [47] were owned by the United States, and 7319 acres were owned outright by the petitioner. During the taxable years the land owned by the State was held by petitioner under grazing leases duly executed under the laws of Arizona for terms of from five to ten years, and the land owned by the United States was held by petitioner under the provisions of the Taylor Grazing Act of June 28, 1934 (48 Stat. 1269), as amended.

This land is in a hot, semi-arid region in the watershed of the Gila River, a tributary of the Colorado River. The major portion of the rainfall occurs during three summer months. Because of climatic and geographical conditions, the lands owned or held by petitioner, together with the surrounding lands, are subject to substantial erosion.

During the taxable years involved petitioner received sums of money from the United States as follows:

1937	$3,586.89
1938	3,247.74

These sums were received by petitioner pursuant to the provisions of the Soil Conservation and Domestic Allotment Act (Act of February 29, 1936, 49 Stat. 163) to reimburse it for expenditures made by it while participating during those years in approved range building practices under the Federal Range Conservation Programs for the Western region of the United States.

Petitioner's participation in the range building program during the years involved consisted principally of the construction or rebuilding on its ranch of certain dirt reservoirs and earthen tanks, together with a rubble masonry dam. In addition petitioner built over two miles of drift fence, deepened a well, and developed a spring, or seep. These improvements were recommended by a range grazing examiner, working in conjunction with the Pima County Range Conservation Committee. Pursuant to petitioner's application, and after completion and approval of these recommended improvements, [48] the above mentioned payments were made to it by the United States, by way of reimbursement for the cost of such improvements.

The cost of the work done by petitioner in each year exceeded the amounts received by it from the

United States. In the petitioner's books of account the cost was not charged to profit and loss account but was treated as a capital item and carried into an asset account entitled "Improvements Under Federal Aid". The amounts received by petitioner in the taxable years were treated as credits to capital surplus.

The total amount received in 1937 represented a reimbursement or payment for improvements made altogether on land owned by the State of Arizona. Of the total amount received in 1938, $899.10 represented reimbursement or payment for improvements made on land owned outright by the petitioner, $2,348.64 on land owned by the State of Arizona, and none on land owned by the United States. These improvements made by petitioner under the Federal Range Conservation Programs for 1937 and 1938 inured not only to the benefit of lands owned or leased by it but also to the benefit of lands in the same range or region, owned or leased by other persons or corporations.

In its returns of income the said amounts were shown as carried upon petitioner's books, but neither sum was included in its taxable income. The Commissioner, however, added each of them to the net income reported, which action resulted in the controverted deficiencies.

V.

The petitioner says that in the record and proceedings before the Board of Tax Appeals, and in

the decision entered by said Board, manifest errors occurred to the prejudice of the petitioner, and it asserts and assigns the following errors, which it avers occurred: [49]

(a) The Board erred in holding that the payments of $3,586.89 and $3,247.74 made to petitioner by the United States during the years 1937 and 1938, respectively, as a result of petitioner's participation in approved range building practices under the Soil Conservation and Allotment Act, were income to petitioner.

(b) The Board erred in failing to hold that the payments so made to petitioner represented reimbursements to petitioner for capital expenditures made by it, and thus should be considered as non-taxable contributions to petitioner's capital assets.

(c) The Board erred in failing to hold that the taxation of such payments to petitioner as income would serve to reduce the benefits granted by the Soil Conservation and Domestic Allotment Act, thus serving to defeat the very purpose of Congress.

(d) The Board erred in failing to hold that such payments constituted gifts to petitioner, and were therefore exempt from taxation under Section 22 (b) (3).

(e) The Board erred in holding and deciding that there are deficiencies in petitioner's income taxes for the years 1937 and 1938 in the respective amounts of $795.60 and $424.46.

Wherefore, petitioner prays that the decision of the Board of Tax Appeals in this proceeding be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript of the record be prepared in accordance with the law and the rules of said Court; and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

JOHN W. TOWNSEND,
1366 National Press Building,
Washington, D. C.
Attorney for Petitioner.

Of Counsel:
CROMELIN, TOWNSEND, BROOKE & KIRKLAND.

[Endorsed]: USBTA Filed Sep. 14, 1942. [50]

United States Board of Tax Appeals
Washington

Docket No. 103848

BABOQUIVARI CATTLE COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CERTIFICATE

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 53, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 19th day of October, 1942.

[Seal] B. D. GAMBLE,
Clerk, United States Board of Tax Appeals.

[Endorsed]: No. 10292. United States Circuit Court of Appeals for the Ninth Circuit. Baboquivari Cattle Company, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of the Tax Court of the United States.

Filed October 24, 1942.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals
for the Ninth Circuit

Docket No. 10292

BABOQUIVARI CATTLE COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STATEMENT OF POINTS AND DESIGNATION OF PORTIONS OF THE RECORD TO BE OMITTED IN PRINTING

In the appeal of the above-entitled case, petitioner adopts and intends to rely on the points covered by its assignment of errors set forth in paragraph V of the Petition for Review filed herein.

In preparing the record in the above-entitled case please print the record as certified by the Clerk of the United States Board of Tax Appeals, with the exception of the following numbered pages:

Pages 14 to 15. Being Amendment to Petition, together with perfected verification.

Pages 28 to 33. Being Exhibits B, C, and D attached to Stipulation herein.

Pages 51 to 52. Being Notice of Filing Petition for Review, together with proof of service thereof on Counsel for respondent.

Pages 52 to ... Being Praecipe for record.

Pages .. to ... Being Order extending the time for the transmission and delivery of the record to the Clerk of the Court.

JOHN W. TOWNSEND,
LLOYD FLETCHER, JR.,
Attorneys for Petitioner.

Service of a copy of the foregoing Statement of Points and Designation of Portions of the Record to be Omitted in Printing is hereby acknowledged this 3rd day of November, 1942.

J. P. WENCHEL,
Attorney for Respondent.

[Endorsed]: Filed Nov. 7, 1942.